Keys to Understanding Your Social Capital

Learn the key elements that make networks powerful and rich in social capital, and discover the traps that hinder their effectiveness.

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As I worked to put this issue together I have had several interesting experiences with social capital. Social capital can be defined formally as the resources that are available to an individual as a consequence of the strength of relationships that a person has with others. Informally, social capital is simply “who you know” that can help you get “what you need.”

My experience with social capital is this: My twelve-year-old son is playing little league football for the local team. I got a call one night informing me that they wanted to split the twelve-year-olds into two teams and asking if I would be interested in coaching. My son was on the team—a fact that should have disqualified me as a coach—and I wanted him to have a good experience playing. I knew that my schedule would allow me to be at all the practices and games, despite the grueling schedule from August through October, so I accepted the offer to coach.

My problem was that I hadn’t played football since high school—and not even much then. But I had taught and developed lasting relationships with several BYU football players. I got out my proverbial Rolodex and began calling these former players. Those contacts provided me with an opportunity to interview a local semi-pro league coach; he helped with the tactics of the game and also had some great advice about the role of a coach. In a couple of days I was caught up on the basics of coaching. That is social capital in action.

We devote this issue to social capital and its role in development and what it can do for development professionals. Social capital is one of the four types of capital that enhance and enable development—the others being institutional capital (the system in which an individual lives), economic capital (an individual’s physical and monetary resources), and human capital (an individual’s knowledge and skills). Social capital plays two important roles for
individuals in any process of development and growth.

First, social capital can substitute for the lack of other forms of capital. In my case, social capital provided a quick substitute for my lack of human capital. Social capital, in terms of access to supply or customer networks, can substitute for economic capital by building a reputation or brand presence. Microlenders use the group lending method as a form of social capital—peer pressure steps in for the lack of legal contracts or repayment mechanisms within a society. Moses Acquaah shows us how a strong network, used properly, can substitute for weak human and institutional capital.

Second, social capital complements the other forms of capital. If an entrepreneur has some economic capital and good connections, he can stretch that economic capital and make it go farther—for example, he can receive extended credit terms from someone in his social network. When an individual can combine human capital with social capital, he can leverage what he knows more effectively by using social capital to fill the knowledge gaps he needs to make his enterprise succeed. Wade Channel provides a thoughtful essay on the role that social relationships play in enabling and constraining the development of the institution of law within the developing world.

Warner Woodworth and Liesl Riddle both draw on their research and teaching backgrounds to show social capital in action and the powerful role it plays in development. They each share the importance of and value in not alienating those from other countries, for many have a strong will to succeed and become self-reliant to help not only themselves and their families but also their home countries. My interview with Brian Uzzi, a noted expert in social capital, takes the issue of social capital in a different direction. Rather than focusing on how social capital impacts development, he chose to focus our conversation on the role of social capital in helping the developers, those who run business, government, or NGO programs working to create self-reliance. He shares a number of powerful prescriptions for developing a strong network rich in social capital.

This issue marks the halfway point in our focus on the four types of capital. I think the last issue on human capital and this issue on social capital used together can help development professionals think more lucidly and insightfully about how their activities are utilizing these important forms of capital now and how they are producing both forms of capital among their clients for future use.

I am excited about the quality of ideas in this issue and wish you a good read. I hope you gain as much insight as I did.

Paul C. Godfrey
Keys to Understanding Your Social Capital

Paul Godfrey discusses the proper building of social networks with expert Brian Uzzi. Uzzi’s award-winning and frequently cited research uses social network analysis and complexity theory to understand human achievement. His research has appeared in numerous journals—domestic and international—and has won many awards and grants. Uzzi is the Richard L. Thomas Distinguished Chair in Leadership at the Kellogg School of Management of Northwestern University, where he has innovated TeamNet®, LeadNet®, Six Degrees of Separation Worksheet®, and Build Your Personal Board of Directors®, each analyzing different facets of networks and giving feedback on how to improve social capital through the networks. Uzzi advises major firms worldwide, including Baker and McKenzie, Deloitte, Pepsico, Credit Suisse, and the World Bank.

Brian, your expertise could help a person who runs an NGO or government agency understand social capital a bit better. Let’s start with the basic question: What is social capital?

The easiest way for people to think about social capital is that it is the value of the contacts in their network. A contact network includes who you know and how the people you know know each other. You can learn a lot about a person’s social capital by looking at that structure alone.

When you think about relationships with the people you know and how those people know each other, I suggest you focus on three essential things. First is the kind of information you get from those people. The second is the kind of skill sets those people have that you don’t possess and would probably have to make a large investment to acquire. Third is your informal power as a leader—are you someone who can get people committed, who can help people interpret mandates, or who can help others draw inferences from data or make sense out of what someone else has told them? Positive social capital lies with someone who is able to get rich information from his network, whose contacts have a diversity of skills, and who gets power out of his network.

The first issue is what kind of information you want, keeping in mind what kind of information is going to be really valuable in your network, for there are many different types. One type of information is everything available on the internet. You can scrape everything off, and it’s publicly available. It turns out, though, that that is not the kind of information that gives someone a position of power and edge. The reason is that if everyone
has access to that information, it gives you no comparative advantage.

You’re not looking for that kind of public information; you are looking for what people call private information. It's unstructured, it’s tacit, it’s not documented, and you won’t find it on the web. It’s often emerging information. You spend a lot of time trying to get it and trying to figure out what it’s all about. What are some good examples a person in an NGO might think of? Private information might include: Are governments taking some of their equity and budget out of one area and putting it into a new area? Are they going to shrink everything all together? Are they going to grow something new that might cannibalize on a particular area? That’s the kind of information that doesn’t appear in the written record anywhere, but it’s being shared somewhere else. That’s all private information, and that’s what flows through your network.

**How do you get that through your network?**

While you examine your network and contacts you need to remember that the big issue is trust. That may sound self-evident. You might ask, what can you tell me about

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### Private information flows through your network.

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trust that’s different? What we have learned about trust in networks is that there are really three important things. One is the self-evident truth that I just mentioned—you have to have trust in your network. When you trade your private information with someone else, you get value back based on trust.

There are also two trust traps. One is that many people just starting to build their networks seem to overbuild their network based on trust. They try to build a lot of trust into it, but when you build a lot of trust into it, you tend to crowd out another dimension of your network. And once you crowd out this other dimension of your network, you have a weak network. That other dimension is diversity, and the problem is called the trust-diversity paradox.

The other trap is that people need skills to turn those who are potential rivals into collaborators and trusting connections. Many people walk away from those who view them with distrust; it’s a lost relationship. But those people who convert those kinds of distrusting relationships into trusting ones really get a big bang out of their social capital. So you have to learn to develop trust with others who you naturally distrust.

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### Is trust enough?

No, the second thing you want to keep in mind about networks is the concept of diversity. Do your contacts have different skill bases, background, training, and ways of seeing the world than you do? If they don’t, you build redundancy in your network, and that turns out to be a bad thing. There’s a phrase used in business: an echo chamber. It’s shorthand for saying that if people in your network have similar backgrounds and training, then really all you get is an echo chamber around you. It doesn’t expand your social capital; it closes you off to things.

There is a very simple mental test to find out how diverse your network is. A good thing to ask yourself is this: Of the people I go to for advice, how many of them also go to each other? It’s a proportion equation. If you go to ten people for advice and five out of your ten go to the same people, then you’ve got a proportion of five out of ten or 50 percent. Seven out of ten is 70 percent, and ten out of ten is 100 percent. As that proportion gets closer to one (or 100 percent), the diversity in your network gets closer to zero.

Many people do not have diverse networks. In a recent survey of American business people, the diversity proportions were 8.2 out of 10. So the average business person you might go to for counsel goes to 80 percent of
the same people that you do. The question is, why? Well, this is the trust-diversity paradox.

Most people have much higher expectations for trusting people who are like them than unlike them. We think that when people are like us we can predict their behavior; we know what their interests are, how they treat problems, and we have a sense of how they will behave when we’re not there to observe them. Those building networks where private information and trust go hand in hand tend to spend a lot of time selecting people who they really think they can trust because it lowers the costs of management and of getting private information.

Of course, what they tend to do is overbuild their networks based on trust. Consequently, they crowd out diversity and are often not even aware of it. The reason they become oblivious to it is that without diversity in their networks they don’t even know what they’re missing; everyone around them shares the same point of view, giving a false sense of security. But in fact, it’s not secure. It’s quite the opposite. It’s a very narrow point of view that doesn’t include a lot of the complexity you would otherwise want. If you have a network where people share the same point of view as you, then you’re just wasting your time. You already have that knowledge. You get a lot of trust but not enough diversity. This paradox is a big trap in people’s networks and makes the networks low in social capital.

Are there ways out?

As a way to give a solution, let me describe what it is that makes social capital so important. I’ve talked about private information and trust and diversity. The third important thing for networks is power. How do you get power from your social capital? Imagine in your mind pictures of networks with the person at the center of a cluster and the people he knows around him and the people they know are around them. You get these clusters, cliques, or pockets. When you map the social world, you find out that, in fact, that’s the way lots of network diagrams look.

It turns out that a large portion of people live in these cliques, but there are a few people who bridge the cliques and bring them together, or if they don’t bring them together, they see the information and the ideas simultaneously. This allows them to be better and more creative in new ways that no one in any single clique could on his own because he lacks the information that someone sees in another network. Those people have a name in a network: brokers. People who have the type of power I’ve mentioned tend to be brokers.

Learn to develop trust with others who you naturally distrust. Turn those who are potential rivals into collaborators and trusting connections.

There is a really well-known research study that goes along with this that some of your readers might be interested in. It was completed by one of the great geniuses of the last century, Stanley Milgram. Milgram discovered this idea of brokers, and along with it, he coined this familiar phrase: six degrees of separation. Brokers and degrees of separation wind up going hand in hand.

Let me tell you about the research because it will help put this in perspective. Milgram had two passions in his life: research and travel. When he traveled he liked to go to typical places like Paris in the springtime or New Orleans for Mardi Gras, and he liked to go to exotic places like Madagascar or Pago Pago. Whenever he would go on these trips, he would play a game with a complete stranger he’d meet. So, maybe while on a tour in Borneo, he’d be sitting in a restaurant in the evening and would see a couple sitting at another table. He would go up to this couple and introduce himself as Stanley Milgram and then ask one of the couple if they
would play a game with him, which was whether the two of them could find a path of people that could connect them to him. Milgram got this idea because in his travels a letter. In the letter is the name of the single stockbroker and instructions: If you know the stockbroker, then send the letter directly to him. If you don’t, send it to someone you know who you think would send it to someone who would eventually get it back to the stockbroker.

Milgram was trying to count links or degrees of separation between people. So, he got all the transmissions back, and he found out that, on average, it takes six intermediaries to connect people who are essentially chosen at random. This is where we get the expression six degrees of separation. He found out something else, though. Sixty percent of the transmissions passed through the same four people. Now ponder on that. That suggests that we’re not really all connected to everybody else, but there are a few people who are disproportionately connected; it is through them that everybody connects to everybody else. Milgram called those people brokers. Brokers hop from cluster to cluster to cluster, and that’s what makes them so effective in organizing a network that meets their needs.

So what is important for your readers to remember about their network? You want trust and private information, but remember that trust has this trust-diversity paradox. You want diversity so that you have different skill sets. Finally, you want brokers because that gives you power.

The big question is, how do you do it?

You have to understand what people use to build their network because some people do it right and some people don’t. You want to learn the principles that people who do it right use. There are basically three principles for building a network. First is self-similarity; we tend to choose people a lot like our selves. Second is proximity; we tend to choose people who just happen to be around us. Third is the shared activity principle.

Self-similarity and proximity are not the best processes. Self-similarity gives a lot of positive feedback, lower costs, and less conflict. There is less disagreement and less need for you to change because you’re not getting information that you don’t already have. Self-similarity is something that people use a lot, and some of that’s okay. Everybody has some self-similarity in their network, but when you have too much, the diversity proportion goes high, and that’s a bad thing.

Proximity is really a consequence of how the world organizes itself. The world organizes things by likeness. That’s why we have departments, units, disciplines, silos,
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and all these other aggregations. Imagine it this way: Most people live their lives in an aggregation with other people a lot like them. As a consequence, their network becomes a reflection of them filled with people just like them. And most people are insensitive to it because it is just a consequence of the habituation of our lives.

Those two things, self-similarity and proximity, build clique-like networks. We have found through research that the thing that helps build powerful networks, high in trust and diversity, is the shared activities principle. The shared activities principle is very powerful because it breaks down the trust-diversity paradox. Basically, it works like this: People who get involved in shared activities of all sorts tend to make contact with people unlike themselves, and the activity itself tends to help you build trust quickly and in a low-cost way with those people. It gives you all the benefits of self-similarity but with none of its downside.

What are some great shared activities for someone who’s part of an NGO? Serving on nonprofit boards, community service, volunteering, team and partner sports, cross-functional teams and committees, etc.—all of those things that bring people together, whether commercially oriented or not, tend to play a very important role. Why? Because people of all backgrounds and ways of viewing the world can be attracted to the same shared activity. The shared activity puts you into a deal stream where you’re coming in contact with diverse people, and proximity gets broken down.

Once you are in that shared activity with these diverse people, how do you build trust with them? Well, it turns out that the activity helps you do that quickly, and that’s the main benefit. You already extend some trust to that person just by being in the activity with them. You couldn’t participate in that activity unless you trust that person, and vice versa.

Also, research shows that when you’re involved in the shared activities, you are profiling the people in the activity. You are looking at their character and qualities, how they act under various circumstances, and how they
Shared activities break down the trust-diversity paradox. Shared activities help you communicate on a more even level with people of different ranks. Shared activities allow you to step out of one script and into another script. Shared activities are an engine for building powerful networks rich in social capital.

deal with the unexpected—even if you are not conscious of doing it. Like a subliminal advertisement, this profiling leaves an emotional footprint or signature that creates a small effect on how we think of that person. Many people believe, again on a subconscious level, that what you observe in the shared activity is in some sense a truer picture of that person’s underlying character than what you get when sitting across the table or desk from each other, times when you’ve had time to script behavior and manage impressions.

So this is why we play golf or basketball with other people?

Exactly! It helps really build the relationship. And, of course, this is building a relationship before a deal comes along. The relationship precedes the deal, which makes the deal go smoother, more simply, more effectively, and less costly. And through this profiling, you get transparency. The other thing is a lot of the shared activities have things at stake. If you win you break a record; if you lose you don’t break a record. You argue with the team to motivate them, and this type of work helps bonding—we either commiserate in loss or celebrate in victory. And bonding builds trust.

What else should our readers pay attention to?

Shared activities are particularly important in two additional ways. Many people in NGOs are building networks and trying to get in front in very little time. They are pressed and have a million things to do. So how do you connect with the people who are already really busy? What you want to do is piggyback on things that they have a deep passion for, a thing they always find time for—and that is usually a shared activity. They care about this thing, and their passion brings them back over and over again. Consequently, you get some opportunity for frequency of interaction that doesn’t draw them away from their schedule or routine.

The second thing is that shared activities help you communicate on a more even level with people of different ranks than yourself. In sociology we have a concept called the script. Basically, in a script every interaction you have with someone follows certain expectations of what is appropriate or inappropriate. We all do it all the time. A script does two things: First, it tends to make us similar to anybody else following the same script. Second, it tends to suppress qualities or characteristics that might be important to the person that he’s trying to reach.

Imagine that in the middle of this interview you all of a sudden start talking; you start saying, “All this makes me think of so and so in such and such; let me sketch out my network and look at this.” You go on for about a half an hour, and it turns out to be an absolutely brilliant, Einstein-like insight about networks. The problem is that the script would mess up my ability to see that brilliant insight because I would become uncomfortable. I would feel you were violating the script, and that violation of the
script would offset any value of your insights and character. That’s the problem with scripts. If you’re running an NGO and you’re trying to meet a government official, an important donor, or a corporation that you want to influence, you are following a script when you meet that other important person. That person is also following a script, and when they see you, you are like every other NGO that they have ever seen because of the script. It’s suppresses your special qualities. A shared activity allows you to step out of one script and into another script where you can show other qualities about yourself that could be valuable to the target person. If you’re going to play squash or golf or be on the nonprofit board, these other scripts allow you to show things about yourself that the professional or hierarchical script does not. Those are opportunities to build trust with people unlike you and show things about yourself that you cannot otherwise show.

Let’s recap. First, you have diversity because you’re in a deal string with a shared activity. Second, you break down the trust-diversity paradox by building trust chiefly with people who are unlike you. Third, you get brokerage as a natural byproduct of trust and diversity. Shared activities are an engine for building these powerful networks rich in social capital.

Many NGOs work in areas of the world where institutions are weak and institutional capital is weak. Governments may even be corrupt, and the rule of law may be suspect. How can positive social capital help people overcome weak institutions?

The first thing that comes to mind is that a lot of the problems you just mentioned are, in fact, due to social capital being used in irresponsible ways. Social capital and networks prefigure in so many different contexts of human achievement. Farmers in sub-Saharan Africa who were the first to adopt pest-resistant crops had these powerful networks. The doctors who get the latest life-saving drugs seem to have these better kinds of networks. In the 1990s, crime in some inner cities of the United States dropped more than 60 percent because police officers changed their networks from bad ones to ones rich in social capital. If you want to do something great, you need to have social capital.

Unfortunately, criminal organizations and corruption also revolve around networks. That’s how things get done. The network is not bad in and of itself; the difference is how reasonably people apply it. When I think about how social capital can help overcome weak institutions, when I look at the literature and talk to people, I discover that social capital has become a lot more sensitive to merit and to the value people bring to the network during the last fifty years. This sensitivity is making it powerful vis-à-vis weak institutions. Credit circles are an example of people using their social capital to overcome corrupt or weak financial institutions. The right kind of social capital allows them to combine resources that they might not individually have or that they struggle with to substitute for these weak institutions.

What’s the dark side? What should people be aware of as they go out and build these networks?

There are a few dark sides. One is this trust-diversity trap. It tends to have people build networks that are not enriching themselves or others; it doesn’t really add value for anyone. It’s somewhat of a benign problem in the sense that no one intentionally tries to fall into the trap.

I think that another dark side of networks also has a benign quality to it. Despite having positive characteristics—small worlds, clusters, and bridges—these powerful networks turn out to be extremely fragile to the loss of just a few super connectors because those super connectors, like the four in the Milgram study, are the ties to everything. If those people are not easily replaced—if other people can’t step in to replace their links quickly—the network tends to collapse rapidly.

The last negative thing to consider is that networks are not good or bad in and of themselves—the people who use them determine that worth. As we learn more about how people use networks and more about how powerful networks can be in their structures, they will eventually be adopted by groups that will use them for selfish purposes. If we were having this conversation a few years ago the first thing that would come to mind would be terrorists. Terrorist cells are cliques and connected by brokers, and they are able to have a very fluid-like structure and do the sorts of things we saw them do because of the network. That’s an extreme example, but members of NGOs need to make sure they are using their networks in appropriate ways.

Endnotes
The concept of social capital—and its role in the process of enterprise development and growth on one hand and the economic and social development of nations on the other—has received strong research interest in most social science fields from sociology and economics to management. Broadly defined, social capital is the actual and potential resources embedded in networking relationships that are accessed and used by actors (e.g., managers of business enterprises) for actions (e.g., conduct of enterprise business activities). The social capital literature has focused on either internal or external social capital. While internal social capital deals with the structure and social networking relationships among actors (i.e., individual members) within a system or organization, external social capital focuses on the structure and social networking relationships between an organization and its important external stakeholders (e.g., customers, government officials, community leaders, and employee association leaders).

The social capital concept is based on the adage that it is not only what you know that affects your performance but also who you know. It builds on the assumption that actors derive benefits from their social networking relationships. The conventional wisdom from most of the social capital research is that social capital is desirable because it is always beneficial to organizations.

Contrary to conventional wisdom, the effects of social capital on business activities and performance is more complex than postulated, and evidence exists to suggest that social capital does not always benefit the outcomes of business activities by enhancing performance. The nature of the relationship between social capital and enterprise performance is critically dependent on the agents with whom firms develop social networking relationships. I want to use my research about social capital in Ghana to discuss the benefits, potential costs, and the prospects of using social capital for supporting the strategic organization of small and medium enterprises’ (SMEs) activities and enhancing their performance in Ghana.

Ghana’s Socioeconomic & Political Environment

When it became the first sub-Saharan nation to gain independence from British Colonial rule in 1957, Ghana was one of Africa’s most successful economies. It had one of the most developed infrastructures in West Africa, one of the most educated and skillful workforces on the continent, and a rich natural resource base, which once made her the largest producer of cocoa in the world.
Recent free-market economic reforms have nurtured an economy that is relatively open, but real institutional change and business infrastructure development have been slow because they have been constrained by cultural norms, social beliefs, and existing bureaucratic procedures and processes. Thus, organizations in Ghana still face significant challenges in terms of their ability to competitively obtain the necessary resources through arms-length transactions. Ghana has had a stable political climate for more than a decade, but corruption is still pervasive because of the presence of red tape and regulatory meddling in the economic and business environment by politicians and bureaucrats.

The political climate in Ghana is characterized by the “winner takes all” syndrome, where the supporters and sympathizers of the political party in power.

Interpersonal relationships and ties are strongly embedded in the social system of Ghana, which is highly collectivistic in nature. Traditional Ghanaian society is organized around kinship groups and collectivist communities, in which the clan and extended family play an indispensable role in creating the norms, values, and behavioral conduct acceptable to the society. The traditional social system in Ghana resembles a series of concentric circles in which the lineage or extended family is at the core. Revolving around the extended family is the web of personal and social relationships within the traditional social organization, which is made up of the clan, the community, and the tribe or ethnic group. The social system or organization (i.e., the extended family, clan, community, and tribe) is governed by kings who exercise traditional political and sociocultural authority with chiefs (i.e., lower level kings) and heads of extended families. Individuals who belong to a particular social system, therefore, exhibit strong loyalty to that social organization and its traditional political and sociocultural authority.

Interpersonal and social interactions, connections, and relationships among members in the social organization are highly emotional and cherished to the extent that the needs of the social group are valued over those of the individual. The social system is thus a corporate organization with a specific identity and membership that owns and manages property; enforces social norms, values, and expected behaviors among group members; and applies social sanctions to members who deviate from the cultural norms. Individuals in the social organization are bound together through various social benefits and obligations and, therefore, are committed to one another by norms of reciprocity and equity. Individuals in the social organization who dishonor this cultural norm are at risk of not only losing their reputation and image but also disgracing their extended family. The behavior of an individual within the social organization is seen as a reflection of the moral character not only of that individual but also of the individual's entire extended family and, sometimes, ethnic group.

Today, Ghana has formal political, economic, and legal institutional structures that govern the conduct of economic and business activities. These formal institutions, which follow British Common Law traditions, are expected to be used for the implementation and enforcement of regulations, laws, and conduct of arms-length business transactions.

However, the laws and regulations enacted by these formal institutions are poorly implemented and enforced, so managers and entrepreneurs in Ghana rely on the connections and relationships they have developed with individuals—both within and outside their social organizations—who have power and authority to help them obtain the resources they require for the strategic organization of their business activities. Modernization and social change in Ghana, which came with the creation of the new nation-state, have created a tension between an individual’s allegiance to the social norms, cultural values, and
behaviors expected by the traditional systems and to the formal laws and regulations of the new nation-state. However, Ghanaians’ ties to their traditional social and political networks are never severed, making them an important substitute for the often inefficient and ineffective implementation and enforcement of the formal bureaucratic arms-length rules and regulations governing business activities.

**Benefits To SMEs**

Personal and social connections and networking relationships provide a pervasive means of obtaining resources for the conduct of business activities by small-scale entrepreneurs in Ghana within an uncertain business environment; weak financial, regulatory, and institutional environment; political favoritism; and a deeply ingrained cultural tradition that is based on strong interpersonal relationships and allegiance to the extended family, clan, and community. Small-scale entrepreneurs, therefore, develop social capital through their social networking relationships with other enterprises (e.g., suppliers, customers, and competitors, community leaders, politicians, and government bureaucratic officials).

Those in the social organization are bound together by social benefits and obligations and are committed to one another by norms of reciprocity and equity.

The benefits of social capital to small-scale entrepreneurs and SMEs in Ghana include the following:

First, developing social relationships with politicians can provide access to resources and information that could be used for the strategic organization of business activities. In Ghana, because of inefficient legal enforcement systems and weak financial institutions, politicians and government bureaucratic officials have considerable power in allocating resources and providing access to information. Despite the liberalization and privatization of most financial institutions and the development of private finance and credit institutions, access to finance through arms-length transactions is still difficult, and developing networking relationships with politicians and government bureaucrats places an entrepreneur or the manager of an SME in an advantageous position to obtain financial resources. With a large public sector, most business contracts are determined and awarded by the government.

Bureaucratic officials also control the regulatory and licensing procedures and processes. In fact, because of the “winner takes all” syndrome in the Ghanaian political environment, developing ties with the officials of the political party in power is a sure way of obtaining access to resources and information for business activities in the form of access to finance, business contracts, regulatory information, and even help with the business registration and licensing process. With strong networking relationships between government officials and large enterprises, which are mostly and contemporary) are the guardians of societal norms, shared understandings, and expectations, which define socially acceptable practices and behaviors in a community’s business environment. Developing social relationships with these community leaders provides a lot of benefits to SMEs. Community leaders are very influential in garnering resources and providing access to valuable information and knowledge. Community leaders offer information about business opportunities, provide access to land for construction and agricultural purposes on favorable terms, and establish links to sources of financial resources and markets for the products of SMEs. They also play a very important role as advertising agents either through personal recommendations or by word of mouth, and provide legitimacy for SMEs and enforcement of business contracts.
among SMEs in their communities. Family members, through their social relationship with community leaders, are also instrumental in helping small-scale entrepreneurs and managers recognize the potential opportunities in their communities as they provide continual support.

Third, when SMEs in Ghana develop ties with top managers of other businesses, with entrepreneurs of larger businesses, and with businesses that are suppliers or customers to the SMEs, they benefit from positive spillover effects, in terms of knowledge flow between enterprises, that are used to improve productivity and performance. Social capital embedded in the social networking relationships with managers of other SMEs who are in the same line can also be an effective source of information about new technology, complementary resources, and opportunities to gain an advantage and mitigate threats in a business environment where the competitive landscape is skewed in favor of those with established connections.

**Potential Costs To SMEs**
Although social capital provides several benefits to small- and medium-sized enterprises, some research has shown that there may be significant costs to developing ties that lead to social capital. For instance, Portes and Sensenbrenner were among the first researchers to argue that while community leaders may act as bridges between small-scale enterprises and the larger community by spreading knowledge and providing access to community resources, community leaders may also expect favors from the small-scale enterprises and entrepreneurs that may overburden those enterprises and hinder rather than improve their performance.

Although my own research from Ghana does not indicate that the ties SME managers develop with community leaders hurt their businesses, the Ghanaian community’s focus on the norms of reciprocity and equity and its function as a “mutual aid assistance society,” in which an individual has both the obligation and responsibility to support the community and the right to receive assistance when needed, implies that successful SME managers are constantly called upon to be the savior of the community by providing jobs, loans, etc., to community leaders who helped them secure access to economic resources.

Moreover, social capital from social ties with some government officials can be costly to SMEs. My research in Ghana shows that social networking relationships with government officials can be separated into those with politicians and those with bureaucratic officials, and their impacts on performance are completely different. While capital from social relationships with bureaucratic officials is beneficial, that with politicians not only can be costly to SMEs but can even hinder their ability to pursue new opportunities that may improve performance. By providing SMEs with privileged access to economic resources for the strategic organization of their business activities, politicians can also either extract and/or appropriate the value they help the SMEs to generate. In Ghana, ties with politicians provide an SME with access to finance from a government-affiliated financial institution or the award of a major business contract, but the SME has to contribute a certain percentage of the funds toward the cause of the government’s political party before the receipt of the loan or the commencement of the contract work.

**Prospects for SMEs**
The business environment in most emerging economies is character-
ized by a weak or nonexistent market mechanism for facilitating arms-length transactions and resource allocation among firms and the existence of an extensive reliance on a redistributive mechanism for resource allocation by the government. The social system is embedded with strong interpersonal relationships and strong loyalty to and trust in the traditional political and sociocultural authority. With this background, there are significant prospects for developing and using social capital for the strategic organization of SME business activities.

First, social capital has the ability to ameliorate the potential inefficiencies and ineffectiveness inherent in the implementation and enforcement of laws and regulations that are supposed to facilitate arms-length transactions. This is even more important in economies where many business transactions between SMEs and buyers or suppliers are too small and the parties are sometimes too poor to use the legal system to redress any wrongdoing. SMEs can use the social capital from the ties they develop as a contract-enforcing mechanism.

Second, social capital can be used to enforce obligations between an SME and its suppliers and customers. This is because the shared norms, values, and trust embedded in the social system and the social sanctions meted out to those who dishonor this cultural norm are powerful incentives that have the potential to align the interests of SMEs and their suppliers or customers for a mutual benefit.

Third, SMEs can use social capital to collaborate with competitor SMEs to obtain and share complementary resources and capabilities. Collaborating with your competitors through strategic alliances, outsourcing agreements, marketing relationships, etc.—which has been called “coopetition”—is an effective way of gaining access to information about new technology, the creation and exploitation of knowledge and learning.

Fourth, SMEs should focus more on the social capital embedded in the ties they develop with their customers, suppliers, and competitors and minimize the social capital from government officials. Research shows
that as economies become liberalized and adopt a free-market system, the benefits from ties with government officials gradually wanes away. In fact, research from Ghana’s young liberalized economy shows that SMEs benefit more from their social rela-

tionships with managers from other firms more than they do from government officials and even community leaders. This indicates that there is the potential for SMEs to rely on their peers to obtain critical resources, capabilities, information, and knowledge in order to exploit opportunities and/or minimize the threats in their market environment. Moreover, they will be less dependent on the government for resources and capabilities for their business activities.

Conclusion
The social capital literature, with data from emerging economies overwhelmingly supports the view that social capital is desirable because it is always beneficial to organizations. But the impact of social capital on SMEs’ business activities and performance is more complex than postulated. My research from Ghana demonstrates that significant evidence exists to show that social capital is not always beneficial to SMEs.

Indeed, social capital has the ability to ameliorate the inefficiencies and ineffectiveness inherent in the implementation and enforcement of laws and regulations.

Networking relationships. A broader characterization of social capital to include community leaders and the separation of government officials into politicians and bureaucratic officials clearly indicates that social capital is not always beneficial. While the preponderance of evidence from the empirical literature in emerging economies has consistently confirmed that social capital embedded in the social relationships with top managers of other firms is beneficial, it is not so with the social capital embedded in the ties with community leaders and politicians. Social capital from both community leaders and politicians has the potential to benefit SMEs, but these agents can also appropriate significant portions of the value they help SMEs create.

Endnotes

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LAW AS RELATIONSHIP: Toward a More Effective and Ethical Legal Reform

By Wade Channell, J.D.
Illustrations by Jenny Peterson
THE WORLD IS AWASH IN A SEA OF LAWS. Consider consumer protection in the United States, which is regulated by twenty-two separate federal regulations,¹ in addition to fifty sets of state regulations and countless district, county, and municipal edicts. More dramatic is China’s legal explosion accompanying its economic explosion. From 1979 to 1983, China passed 4,119 laws and regulations. Between 2001 and 2004, the number had grown exponentially to 94,299.² Local, national, regional, and international rules and regulations touch upon every aspect of human behavior and commercial activity.

These are only the official regulations of governmental bodies; individuals and companies constantly create their own private laws through contracts. Credit card applications, automobile sales agreements, medical waivers, and insurance contracts all expand the rules we live by, based on our willingness to accept them and backed by the willingness of the court system to enforce them.

Despite this all-encompassing application of law to life, the plethora of rules and regulations has a single common denominator. Law regulates one thing and one thing only: human relationships. Human rights and criminal laws place limits on how I may treat my neighbor; corporate governance codes lay out complex relationships among directors, managers, shareholders, employees, and increasingly, the surrounding community. Each—whether constitutional, regulatory, or contractual—expresses how people are expected to relate in certain situations and the consequences if they fail to do so.

Law is both a product of and contributor to human relationships. The continuum of public and private laws provides a way of setting rules of behavior within a relational context. Those relationships include both stated mutual understandings and unstated assumptions. When well formulated, laws are established through analysis, discussion, and give-and-take of parties, speaking for a larger constituency, who bargain over legitimate-but-differing needs and interests. Through this process, the rules of behavior arise from mutually acceptable forms of negotiation. When poorly formulated, a few individuals with the power to enforce can simply mandate the relational rules by fiat or exclusionary negotiations, without sufficient regard for those whose behavior and interests will be affected. Attention to relationships in lawmaking directly influences the success of later implementation and enforcement as well.

IMPLICATIONS OF LAW AS RELATIONSHIP
If it is true that law regulates relationships, then legal professionals, legislators, and legal reformers would do well to base their legal analyses on this premise. Legal reform is a substantial industry. In the developing world, legal reform is a form of technical assistance provided by numerous international financial institutions and bilateral donor organizations to help countries in transition and developing countries attain greater economic growth and democratic freedoms. The effectiveness of such assistance is highly dependent upon the extent to which it recognizes and reinforces the relational underpinnings of law.

Many countries have well-developed systems for negotiating needed reforms through purposeful involvement of varied stakeholders in a participatory process. Elsewhere, especially where the legislative process tends toward fiat, reformers can ignore large sections of the population in passing laws. Each approach sends a message about relationships between governed and government; correctly weaving a relational understanding into legal reform results in far more effective lawmaking.

Unfortunately, many legal reform efforts worldwide take a mechanistic approach to lawmaking. Laws are seen as components that can be removed and replaced to upgrade the performance of a given policy. Consequently, it does not much matter how the process is completed as long as the law is adopted, preferably on a fast-track basis with few delays from comment, review, or analysis by stakeholders or even parliaments. The point is simply to upgrade the legal framework. The paternalistic assumptions of this approach ignore the underlying social relationships that the rules should be designed to address, and regularly lead to a situation in which laws are not implemented but merely adopted.

RELATIONAL LAWMAKING
A relational approach to matters of law and policy begins with a better informed understanding that the
Legal reform interventions within a system of complex relationships. Secured lending laws, for example, permit borrowers and lenders to reduce the costs and risks of credit transactions by behaving in a certain way (i.e., registering the transaction) that limits fraud and misunderstanding, which in turn leads to greater access to affordable credit. Other laws mandate behavior to avoid penalties, such as a tax code. In both cases, the regulatory regime supervises how people act: it either permits or prohibits certain behaviors by creating positive rewards and opportunities or applying negative sanctions and penalties.

Yet law is much more than the simple regulation of behavior. It arises from and defines individual and social relationships. The nature of the relationships in turn fundamentally affects how and whether the proposed behavioral regulations can be implemented or enforced as intended. Implementation arises from consensus—when people agree on what should be done, they can then implement that agreement. Enforcement is a product of agreement as well—when one party diverges from an agreed upon course of action, force may sometimes be legitimately employed to compel the recalcitrant party to honor the terms of the agreement.

Laws, regulations, and other rules work best when those subject to the laws believe them to be sufficiently legitimate. Legitimacy arises from the combination of at least three sources of basic legitimacy: substance, procedure, and representation. All of these are connected to relationship and either reinforce or undermine the purposes of lawmaking.

Substantive legitimacy is achieved when the content of the law adequately addresses the need being regulated. For example, a legitimate regulation on building standards for earthquake zones should not be based on building standards for oceanfront property outside of the zone. The substance must match the purpose so that the desired behavior—building safer buildings—will be achieved.

Procedural legitimacy arises from adequate compliance with an agreed upon system of rule making. Compliance, however, will establish legitimacy only if the procedure itself is considered legitimate; this is the essential difference between rule of law and rule by law. A government can fully comply with established procedures to enforce its will, but if the procedures are considered illegitimate, such as providing no vehicle for public input, then the substance will be difficult to enforce, even if the law itself is excellent.

Representational legitimacy is concerned with the participants in the process. Most lawmaking is done through representatives of the governed: parliamentarians, executive agencies, and specialized bodies. If those who make the laws are not considered legitimate representatives of those subject to the laws, then the laws will be considered illegitimate. Colonial governments imposed by force, for example, are generally not considered legitimate by local populations. Consequently, colonial laws—even if substantively and procedurally legitimate—are often considered illegitimate.

The importance of legitimacy can easily be seen through examples of international economic development programs. Legal reform interventions are intended to establish the framework for commerce by setting up the “rules of the game” in accordance with proven international standards. The goal, frequently, can be described as the adoption of well-written laws, based on an unstated belief that substantive legitimacy is sufficient to achieve the socioeconomic behavioral goals addressed by the law.

Albania, after decades of isolation under the Hoxha regime, rejoined the international community in 1993. Europe and the United States rushed to assist in the transition to a Western-style, market-oriented, democratic system of government. By 1995, Albania had adopted a wide range of fundamental commercial regulations, such as a bankruptcy law, company law, and a commercial code. Yet few of these laws were effectively implemented. One Albanian legal professional explained that Albania had many excellent laws from France, Germany, England, and even the United States, but that these were not perceived as Albanian laws and, consequently, were not used.

The laws may have been substantively adequate but were adopted primarily through use of foreign drafters
People accept the rules of the game because they respect the system by which the rules are made.

became law. One banking regulator frequently sought comments from the banking community before implementing new regulations but did so out of good will. Not all officials had such good will. From a legitimacy standpoint, process and representation were lacking.

Croatia provides examples of both proper and improper attention to legitimacy. In the late 1990s, Croatian legal experts decided to draft a new law governing associations. A national umbrella association, with more than ten thousand local associations as members, discovered the initiative and asked to be included in the process. The drafting team begrudgingly gave the association two weeks to comment on the draft before submitting it to parliament. The comments, along with requests for further discussion, were ignored, and the law was passed. The association challenged the resulting law in court, where the law was found to be unconstitutional in at least 50 percent of its provisions. At this point, legitimacy had failed at the substantive level—procedurally by rejecting meaningful participation and representationally by failing to include sufficient expertise on the drafting committee.

The national association thereafter sought to engage the drafters in a more meaningful, effective approach. First, they supplied experts from the International Center for Not-for-Profit Law (ICNL) from Budapest to assist the local experts in redrafting the law. Once satisfied, the drafting committee permitted the national association to send the draft for comment to the association’s members, which by then numbered thirteen thousand associations. Yet these relatively new organizations had little understanding of how to interpret and comment on a piece of legislation, so only ten of the thirteen thousand members submitted comments. Rather than consider this process sufficient, however, the national association arranged for meetings around the country in order to explain the draft, thus eliciting hundreds of useful comments, many of which resulted in amendments to the draft. When eventually submitted to parliament, the law was readily passed and thereafter readily implemented based on the consensus and substantive quality achieved during the process.

The three-fold approach to legitimacy explored in these examples rests on a respectful approach to relationships. When lawmakers include the stakeholders who will be affected by new laws, they not only provide for greater substantive input and local ownership but they also foster healthier relationships between government and governed. Even a cursory look at the unstable regions of the world reveals a chasm between government and governed, rulers and ruled. Inclusive policy making and legislative processes provide an essential tool for reformulating societal relationships.

RELATIONSHIP AS THE BASIS FOR ENFORCEMENT

When policy making and legislative processes are based on participation by affected stakeholders, the processes both recognize and reinforce the relationships between all parties. Law and policy are generally negotiated among competing interest groups, sometimes with mutually exclusive interests. The process allows the parties to buy into the system that produces the rules.

When they perceive that they are appropriately represented, given a chance to voice their opinions, and exposed to the arguments of competing interests, parties are more likely to consider the outcome legitimate, even if it does not fully achieve their aims. In other words, they accept the rules of the game because they respect the system by which the rules are made. This has implications for implementation and enforcement of those rules.

Implementation is a product of consensus. Agreements can be implemented, but when there is no agreement, there is nothing to implement. In the Croatian case noted earlier, the second association law was readily implemented because the process produced mutual understanding and agreement among the relevant actors. In Albania, little implementation followed passage of new laws because little if any consensus had been achieved through the process.

Consensus requires understanding, and understanding requires com-
munication and participation in the process. Understanding is achieved only when there is effective communication among the parties to the agreement. For legal reform programs, this communication must often take the form of public education and outreach. During the lawmaking process, outreach is used to ensure feedback from stakeholders to inform the content of the reforms. Once a reform is passed, public education is needed to announce the changes, explain how they were legitimately achieved, and explain the practical implications of implementation, including benefits of compliance and costs of non-compliance.

Trust, like understanding, is fundamental to enforcement and implementation. At the most basic level, all economic transactions are founded upon some form of trust relationship. In an intimate society, such as a rural village, trust can be enforced through social sanctions. When commercial transactions are extended in a less intimate setting, where the parties have no pre-existing relationship, laws and legal systems provide proxies for trust.

This continuum of trust has an impact on economic development. Robert Cooter and Hans-Bernd Schaeffer point out that in developing countries there is a trust gap that damages development. In a country such as Mozambique, for example, transactions at the village level are vibrant, with little concern for default. Likewise, a merchant in Maputo will readily enter into agreements with a trading partner in London. Yet that same merchant may not undertake a contract with a fellow merchant from a distant Mozambican city. The apparent anomaly is actually consistent with issues of trust. In the village, direct relationships establish trust while social networks ensure compliance. In the international transaction, Mozambicans will trust British courts to enforce the contract fairly should there be a breach, even though they may not fully trust their British trading partners. Yet in Mozambique, merchants who do not know one another know that they cannot trust the local courts to fairly apply legitimate laws. This is because the proxy for the trust relationship between individuals—trustworthy laws and institutions—is insufficient. Trust is ultimately a question of the quality of relationships, whether between the parties to a transaction or between the public and the institutions of government needed to ensure compliance.

Many a legal reform initiative has floundered on the shoals of misunderstanding of market norms and social norms, which often have different aims but can easily be confused to the detriment of an otherwise well-executed reform initiative. Market norms define the parameters of relationships related to transactions.
The market requires clear rules, predictable outcomes, with specific rewards and sanctions applied for success and failure at each point along the way. These norms hold the market together. Social norms, by contrast, preserve social relationships. They are less concerned with costs and benefits and more concerned with harmony and stability in the social fabric. Market norms seek to reconcile accounts; social norms preserve relationships. One focuses on financial reparations, the other on relationship repair. Both norms are valuable; both serve important functions. Yet each can undermine the other.

Commercial laws establish rules based on market norms. However, the judges and other officials in developing or transition economies who are expected to enforce the rules often unknowingly apply social norms. This is normally due either to a lack of training about how the market works or to an excess of indoctrination about the supposed superiority of social norms. In either event, this can result in a weak and ineffective set of market rules and laws.

Similar confusion creates dangers elsewhere in the economy, when political norms (a subset of social norms) are confused with market norms. Political debts are paid off through political actions, such as delivering votes or supporting a political initiative. Market debts are paid off by fulfilling the terms of the contract. In many countries, political leaders direct lending through banks in order to enhance political relationships. If the debtor fulfills the incumbent political obligations, the government may choose not to enforce the loan agreement.

Unfortunately for the bank, however, the loan agreement is set in market terms, so the bank must absorb the loss without meaningful recourse to enforcement. Banks are protected only when laws do not permit such protection from repayment but instead enable banks to enforce their commercial relationships without regard to the underlying political relationships.

Legitimate processes, coupled with sufficient public education, can establish the relationships and the understanding of those relationships necessary to create trustworthy institutions that will enforce market norms and enable economic development. Laws alone, even when substantively legitimate, cannot achieve this goal.

**ETHICS, RELATIONSHIPS, AND LAWMAKING**

Trustworthy legal systems and institutions cannot be built or maintained without an undergirding support structure of ethics. Ethics—whether personal, professional, legal, governmental, or corporate—are the mainstay of the rule of law and the culture of accountability needed for economic growth and social stability. Ethics can best be understood as behavioral obligations reasonably expected by parties to a relationship. As a starting point, this means that ethical obligations depend on an underlying relationship and cannot exist properly without one. Likewise, the nature of relationships defines what can reasonably be expected.

For example, lawyers are subject to a code of ethics that provides for different obligations to different parties. To their clients, lawyers owe a duty of representation, which is strict but not absolute. Thus, a lawyer must maintain confidential information of the client, for example. The lawyer cannot, however, lie to the client’s adversary about such information because the lawyer has an a priori relationship with the legal system, which forbids fraud. The lawyer must be truthful to client and adversary alike but need not be volunteer unprivileged information to an adversary unless asked. At the same time, ethical standards provide that a lawyer must reveal legal arguments that undermine the client’s case because the lawyer has a duty to the court to protect the system of justice. In some cases, a lawyer must even violate protected confidences of a client if the client appears likely to commit a crime, because the lawyer has a greater duty to society. These overlapping circles of relationship—client, profession, court, society, and adversary—define the parameters of behavior and appropriate expectations within each relationship.

Ethical obligations are violated when a person betrays the reasonable expectations arising from a relationship. Judges, for example, have a professional relationship with all liti-
Trustworthy legal systems and institutions cannot be built or maintained without an undergirding support structure of ethics.

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The views expressed herein are the author’s own and do not necessarily reflect the views of the United States government or USAID.

Endnotes
3 All examples cited are based on personal experience of the author.
4 For a thorough exploration of trust in commercial transactions, see Robert D. Cooter and Hans-Bernd Schaefer, “Law and the Poverty of Nations,” (paper presented at a review conference held by the Mercatus Center of George Mason University, May 2007).
Diasporas: Exploring their Development Potential

By Liesl Riddle

Globalization has not only given rise to an accelerated flow of goods and services around the world but has also fostered an increase in the movement of people across borders. In their new countries-of-residence, migrants often acquire new knowledge, skills, social contacts, and financial resources. Even though they may be far from home, migrants often maintain social and psychological connections to their countries-of-origin. They often encourage their children and grandchildren to continue these homeland connections. "Diasporans" are individuals who "reside outside of their perceived homeland, whether independent or not. They regard themselves, or are regarded by others, as members or potential members of the national community of their homeland, a standing retained regardless of the actual status of their citizenship inside or outside..."
their homeland.” Diaspora capital—human, social, and financial—may be a useful development resource for migrant-sending countries, many of which are among the most capital needy in the world.

Today, a host of actors engaged in poverty-reduction activities—policymakers, NGOs, socially responsible businesses, and academics—are asking the question: How can diaspora capital be mobilized and utilized in development activities? Researchers at The George Washington University have formed an interdisciplinary research group, called the GW Diaspora Capital Investment Project, to examine an increasingly popular way diasporans are contributing to development: by investing their capital in existing businesses and setting up new ventures in their countries-of-origin. The research team explores the underlying motivations for this transnational economic behavior, estimates the market potential for various diaspora investment alternatives, and identifies policy and marketing best practices for national governments, aid agencies, multilaterals, and NGOs seeking to cultivate and facilitate diaspora investment and entrepreneurship.

Diasporas in the 21st Century
Coined in the third century, the term diasporas originates from the Greek word διασπορά, “a scattering or sowing of seeds.” Traditionally the term was limited to the Jewish dispersion. But since the early 1990s, many dictionaries have expanded the definition to include any body of people living outside their traditional homeland.

This broader definition reflects the changing magnitude and nature of global migration. Since 1975, world migration has more than doubled. Today, approximately 3 percent (150 million people) of the world’s population are migrants, of which many have emigrated from a developing country to a developed country. One in ten persons living in a developed country today is a migrant.

Innovations in transportation and communication technologies now allow migrants to psychologically and physically connect with their countries-of-origin in ways that were virtually unimaginable in the past. Declining costs in air and other transportation modes make it easier for immigrants and their descendants to visit their countries-of-origin and have inspired the development of “heritage tourism.” Global media provide immigrants with a constant stream of information about their origin countries. Ethnic bulletin boards, cyber communities, and e-commerce sites on the internet offer migrants an opportunity to socially connect not just with each other but also with family, friends, and other individuals in their country-of-origin.

For many diasporans, the experiences and opportunities they are exposed to in their countries-of-residence inspire them to seek ways to contribute to the development of their countries-of-origin. Some join diaspora advocacy groups, lobbying the governments of their countries-of-residence on behalf of development issues in their countries-of-origin. Other diasporans strive to enhance the development of their countries-of-origin by engaging in philanthropic activities, raising money in the countries-of-residence, or volunteering their time for social and environmental organizations located in the countries-of-origin.

But, increasingly, diasporans are searching for avenues to extend their development impact beyond politics and philanthropy. They seek ways to leverage the human, social, and financial capital they have acquired to make investments and establish new businesses in their countries-of-origin.

Diaspora Investment & Entrepreneurship
For many developing countries, individuals living in the diaspora earn relatively higher incomes compared to those earned by individuals living in the country-of-residence.
These higher incomes increase the potential for investment and entrepreneurial activity among diaspora populations as higher incomes may result in greater amounts of disposable income available for economic investment. This is particularly true when an origin country's income per natural (i.e., the mean income per person of those born in the origin country regardless of current country-of-residence) substantially exceeds its gross domestic product (GDP) per capita. In a 2008 study, Clemens and Pritchett estimate that income per natural exceeds GDP per capita by 10 percent or more in almost thirty countries. In some smaller countries with large emigration, the differential is much higher. For example, the difference between income per natural and GDP per capita exceeds 103 percent in Guyana, 81 percent in Jamaica, 60 percent in Albania, and 51 percent in Liberia.³

Many diasporans remit money back home to friends or family. In 2006 more than 1.5 billion separate remittance transactions were made, mostly in increments of US$100, $200, or $300. Taken together, these remittance payments account for a substantial flow of cross-border capital: Global total remittance flows in 2006 were estimated to be US$300 billion. Diaspora remittances are key sources of capital inflow for many developing countries. In 2006 remittance flows to developing countries totaled US$167 billion, a sum two times the amount of development aid sent to those countries from all sources. India, China, Mexico, France, and the Philippines are among the world’s largest recipients of remittances. In some smaller countries, such as Moldova, Latvia, and Haiti, remittances comprise the largest share of the total economy.

But many diasporans seek ways to become more economically invested in the economies of their countries-of-origin beyond making remittance payments. Bal Joshi, is a prime example. Born in Nepal but educated and now living in the United States, Joshi created Thamel.com, a web portal allowing Nepalese diasporans to purchase goods and services online from Nepalese suppliers and have them delivered to the homes of friends and family living in Nepal. Joshi’s investment has generated many benefits for his home country. Thamel.com has created more than four hundred new jobs, improved the operational efficiencies and quality control of its local suppliers, and broadened the array of goods and services its suppliers provide to consumers. Thamel.com suppliers earn more than 30 percent of most local suppliers in terms of annual sales; during festivals Thamel.com suppliers earn on average 50 percent more than their competitors.

Diaspora investments do not always involve the internet. Some diasporans set up service operations, such as restaurants, retail chains, consulting companies, or tourism-oriented enterprises. Others create manufacturing facilities in their home country, producing goods for local and/or export sale, or establish subsidiaries for businesses based in other countries. In some cases, these investments are made by “diaspora foreign direct investors,” or diasporans who already own and operate a business based outside their country-of-origin. But in many other instances, the service or manufacturing operation established by the diasporan is a new venture, or an example of “diaspora entrepreneurship.”

The development impact of diaspora investment is often discussed in terms of the growth of emerging giants, China and India. As an article in Foreign Policy aptly noted, “With the help of the diaspora, China has won the race to be the world’s factory. With the help of the diaspora, India could be the world’s technology lab.” But, the impact of diaspora investment and entrepreneurship extends beyond the emerging markets of China and India. Diaspora investment and entrepreneurship are particularly important for nations that might be deemed less attractive by non-diaspora investors because of small domestic market size, inadequate infrastructure, or less-attractive structural characteristics. Diaspora investment also plays an important role in the reconstruction of many post-conflict countries. The positive economic impact of diaspora homeland investment flows in Afghanistan, Liberia, Sierra Leone, and other post-conflict environments have been recognized by the United Nations.

Even developing country governments that are underwhelmed with foreign direct investment (FDI) as a whole have begun seeking creative ways of encouraging diaspora investment. Skeptics of FDI as an economic development tool often voice concerns that FDI is not always efficiently invested. They argue that it crowds out domestic investment; displaces local firms in production, service, and financial markets; generates a reduction in local competition; and leads to lower quality products and inflated prices in local markets.

Many governments believe that diaspora investment has a greater chance of yielding business operations that are more beneficial for development than non-diaspora FDI because diaspora investment and entrepreneurship often is not just driven by the quest for profit maximization; social and emotional motivations also play a role. Some seek the potential emotional satisfaction they receive by “helping out the homeland” or feel it is their duty or obligation to contribute to the country-of-origin
In many cases, investing in the country-of-origin is deemed an honorable activity within diaspora communities or by friends and family back in the country-of-origin. The social recognition a diasporan receives by investing in the origin country may also be a key motivating factor.

These nonpecuniary investment motivations may incentivize diasporans to make investment decisions that may or may not generate immediate rich profit rewards but instead may sew the seeds of an investment in the country’s long-term economic and social development. For example, diasporans’ emotional and social investment concerns may make them more likely to keep their capital in the investment-destination country rather than repatriate profits. They may be more likely to reinvest in their established operations or use the profits to establish additional new ventures in the country-of-origin economy. Diaspora investments may also be less vulnerable to capital flight in a time of crisis.

The emotional and social drivers of diasporans’ investment interest may inspire diaspora investors and entrepreneurs to serve as economic change agents, leveraging their investment and new venture creation to strengthen the country-of-origin economy. One of the main goals of diaspora economic activity in the country-of-origin may be to generate employment—for their family, friends, local community, or nation. Thus, diaspora investors and entrepreneurs may be more likely to establish greenfield activities rather than merely merge with or acquire existing firms in the country-of-origin economy. They may prefer local inputs and employees over imported products and labor, making them more likely to strengthen and cultivate local supply chains.

The presence of diaspora investors and entrepreneurs in the country-of-origin’s economy also may contribute to the internationalization of domestic firms in the country-of-origin by enhancing local firms’ transnational social capital. Diaspora investors and entrepreneurs often share market information about their country-of-residence with other entrepreneurs and firms in the country-of-origin, such as information about import and operational regulations, consumer demand, and competitive intelligence. Domestic firms can utilize connections that they have with diaspora investors and entrepreneurs to tap into the

**DIASPORA CAPITAL INVESTMENT PROJECT**

**WHAT ARE THE NECESSARY FACILITATING INSTITUTIONS?**
IntEnt Field & Survey Studies

**WHAT IS THE MARKET POTENTIAL?**
WHAT ARE THE PSYCHOLOGICAL DRIVERS?
Diaspora Investment Motivation Study

**HOW CAN GOVTS ATTRACT DDI & D-ENTREP?**
UN Cross-National Policy Comparison Study
Investment Promotion Agency Study

**WHAT IS THE EFFECT ON INSTITUTIONS & DEVELOPMENT?**
Change-Agent Case Study Project

**WHAT ARE THE DIFFERENT BUSINESS ENVIRONMENT PERCEPTIONS & FIRM PERFORMANCE?**
Matched Sample Study
diaspora investor/entrepreneurs’ transnational networks to identify business leads, opportunities, and financing in markets abroad. Diaspora investors and entrepreneurs can serve as reputational intermediaries for domestic firms in foreign markets.

Migrants who venture abroad often gain knowledge and skills that are lacking in the country-of-origin. When they return to invest or start a new business, they remit this acquired human capital back to the origin country, thereby turning “brain drain” into “brain gain.” Diaspora investors and entrepreneurs also serve as transnational knowledge linkages, contributing to the diffusion of technology and production know-how from individuals in the country-of-origin to the country-of-residence.

Diasporans may be interested in investing in their home countries but may be inhibited or unable to do so due to a lack of available time, financial resources, know-how, and/or other constraints. New investment vehicles are becoming available that allow diasporans an opportunity to invest in their countries-of-origin quickly, easily, and with small amounts of capital—all without ever leaving their country-of-residence. For example, diasporans can lend money to firms back in their home country at below-market rates of interest through organizations like Kiva and Investors without Borders.

Some diaspora organizations have established venture capital funds that purchase equity in businesses in the country-of-origin. Some governments, such as those of Israel and India, have targeted bond offerings to their diaspora communities abroad. In some cases, diasporans invest in companies listed on the stock exchange of their country-of-origin or purchase mutual funds consisting of companies from their home country.

The GW Diaspora Capital Investment Project

Existing research concerning diaspora investment and entrepreneurship is scant, and the majority of current scholarship is theoretical or based on anecdotal evidence. Thus, the policy and marketing efforts undertaken by governments, aid agencies, multilaterals, and NGOs are being crafted and executed based mostly on hope and conjecture, without the benefit of rich and robust scientific data. The GW Diaspora Capital Investment Project (GW-DCIP) seeks to fill this information vacuum.

Formed in 2006 by GW professors, Drs. Liesl Riddle and Tjai Nielsen, the GW-DCIP is a collaborative research effort of faculty and students from a variety of academic disciplines across the university, including economics, international affairs, international business, management, and public administration. The research team is engaged in several different studies of diaspora investment and entrepreneurship designed to probe the phenomenon longitudinally from the pre-investment, investment, and post-investment phases (see Figure 1). GW-DCIP is part of GW’s Diaspora Program, a broader research initiative at the university exploring the relationship between diasporas, development, and policy.

The first goal of the research initiative is to better understand to what extent and why diasporans are interested in investing in their home countries. In this line of inquiry, the GW-DCIP aims to estimate the market potential within and across given diaspora groups for various investment categories, such as setting up service or manufacturing facilities, purchasing home country bonds, or contributing to venture capital or lending funds in their countries-of-origin. A central objective of this research is to identify whether diasporans interested in investing or starting a new company in their country-of-origin fit a particular demographic profile or share similar psychological motivations for investment.
GW-DCIP has created the Diaspora Investment Motivation Survey to generate answers to these questions. Currently, GW-DCIP is working with organizations in Afghan, Lebanese, and Liberian diaspora in the United States to administer the survey in their respective communities. Although the Diaspora Investment Motivation Survey could be administered to any diaspora community, GW-DCIP is focusing their data collection efforts on these post-conflict countries because of the significant capital requirements necessary to rebuild and develop these countries. The team plans to extend the Diaspora Investment Motivation Survey to Afghan, Lebanese, and Liberian diaspora communities outside of the United States and to other diaspora groups in the next phase of research to broaden the database and enhance the generalizability and comparability of the study findings.

The GW-DCIP also is engaged in research to identify ways that governments can attract diaspora investment and entrepreneurship through marketing and other promotional efforts. The study team was commissioned by the United Nations to conduct a cross-national comparison of policies to promote diaspora investment and entrepreneurship for a forthcoming volume on diasporas and development. In 2009, working in conjunction with the World Bank’s Foreign Investment Advisory Service, GW-DCIP will administer a survey to all national investment promotion agencies in the world to catalog the various services and organizational changes these agencies have put in place to encourage and support diaspora investment, and to assess the perceived effectiveness of these programs.

GW-DCIP is particularly interested in identifying ways to turn diaspora investment and entrepreneurship interest into meaningful investment in the country-of-origin. Discerning the obstacles that nascent diaspora investors and entrepreneurs face is an important first step. But in some cases, facilitating institutions—organizations that provide potential investors and entrepreneurs with the skills and knowledge that they need to overcome those obstacles and bring their investment or new venture to life—may be necessary to generate sufficient diaspora investment activity. GW-DCIP has conducted field studies with IntEnt, a business incubator located in the Netherlands, to better understand the hurdles that new diaspora investors and entrepreneurs face and the role that business incubators can play in helping turn diasporans’ investment interest into an investment reality. Longitudinal field studies with recipients of IntEnt’s business incubator services also are planned to shed light on how the challenges and needs of diaspora investors and entrepreneurs change over time during the investment process.

Most importantly, GW-DCIP investigates the ways in which diaspora investment and entrepreneurship affect the political, economic, and social development of their countries-of-origin. The team is currently developing a compendium of exploratory in-depth case studies of diaspora investors and entrepreneurs whose investments have brought about significant positive change in their respective countries-of-origin. Collected for teaching and research purposes, the case studies illuminate commonalities in investment motivation and vision and contrasting avenues for innovative change and development impact.

The team has also begun to investigate other post-investment related issues. For example, a pilot study
utilizing an industry matched sample has been launched in Ghana to explore performance and other differences among diaspora foreign investment firms, non-diaspora foreign investment firms, and local firms.

Conclusion

“No gold did they find, 
Underneath any stone
They touched and turned,
Yet
Every stone they touched,
Into solid gold they turned.”
—Vishwamitra Ganga Aashutosh

Reciting this quote in an address at the Pravasi Bharati Divas (Non-Resident Indian Day) in New York City on 23 September 2007, Vayalar Ravi, India’s minister for overseas Indian affairs, eloquently described the hopes that many have for the development potential of diaspora investment and entrepreneurship. The GW-DCIP hopes to provide data that will better inform diaspora investment and entrepreneurship promotion efforts and enhance academic understanding of the diaspora investment phenomenon.

Endnotes
1 Yoshi Shain, Kinship and Diasporas in International Affairs (Ann Arbor, MI: University of Michigan Press, 2007), 11.
4 http://www.thamel.com
6 http://www.kiva.org
7 http://investorswithoutborders.wordpress.com

ABOUT THE AUTHOR

Liesl Riddle is an associate professor of international business and international affairs and is the co-director of the GW Diaspora Program at The George Washington University. Riddle has written extensively on diasporas and development, international entrepreneurship, and trade and investment promotion. She has conducted fieldwork in Egypt and Turkey and in diaspora communities in the United States and Europe and is a member of a United Nations’ advisory panel concerning diaspora investment and entrepreneurship policies. Riddle holds master’s degrees in Middle Eastern studies, and marketing and international business, and she received her doctorate in sociology.
Social Capital is an important dimension of the microcredit process, yet it has received but scant attention in the literature. My close friend and mentor, Muhammad Yunus, recently declared that the system of microcredit he values “gives high priority on building social capital.” Likewise, James Wolfensohn, former head of World Bank, has declared that social capital is the “glue” that “holds societies together.”

At the outset, I want to make a preliminary point about types of microcredit programs. On the Grameen Bank’s web site several months ago, Yunus argued that we need to be more precise when writing about the term microcredit because of the various models and different features that are emerging. Per his suggestion, I will use the following criteria, paraphrasing Yunus: The mission must help poor families help themselves to overcome poverty, should particularly target poor women, and should not be based on collateral but on trust. Further, such credit is to be used to create self-employment and income-generating activities, not consumption. Finally, to receive a microloan one needs to be a member of a borrower peer group.

The type of microcredit on which this paper focuses must be centered on the norms and values of Yunus’ description. With this context, let us define social capital, address ways that it can play a role in the MFI movement, and articulate the need for further action research that will foster greater amounts of social capital in the future.

Characteristics of Social Capital

We start with what social capital is not, as a way to approach it by the back door. The opposite of social capital may best be described as “social Darwinism.” British philosopher Herbert Spencer coined the phrase “survival
“of the fittest” in 1866, before Darwin’s scientific view of evolution was published. He and his associates claimed that might makes right and that not only nature was a jungle but so was human society.

On the other side, a more optimistic concept of human value—social capital—emerged. It was a term first used nearly a century ago in the United States by a rural West Virginia school administrator, Judson Hanifan. He suggested that as the rural poor enjoy relationships such as good will, fellowship, and interaction, there will be an accumulation of resources that moves a person from isolation toward a sense of community and cooperation. Decades later, sociologists and political scientists began to reference the concept. They argued that social capital was an alternative to the notions of financial capital, intellectual capital, and even the more recent, human capital. While some authors tend to describe social capital rather abstractly, my use of the term draws from such practical notions as networks, trust, and mutual engagement.

To me, social capital is an intangible, yet significant, resource that bridges human relationships through common or shared interests. It generates a sense of mutual interdependence in which human beings develop a level of confidence and interest in one another, along with respect and willingness to help each other. I suggest that microcredit approaches must have a high degree of social capital. Microcredit is not just about money. It is not simply a financial construct. Instead, genuine microcredit must generate social dynamics between the borrowers during their acquisition of microloans and their progress out of poverty.

In fact, it seems that the MFI movement was derived from the lack of social capital in society, particularly in the third world. By and large, the third world poor have
suffered from social isolation or marginalization that has kept them at the base of the societal pyramid. Those at the top and in the middle are linked together by the formal economy, the political infrastructure, the national education system, and so forth. In contrast, those at the base are disenfranchised and disconnected and lack the bonds that tie society together. The consequence is often a struggle for survival—fighting over land or jobs, shame and disintegration of the family, and so forth. Economic poverty has the damaging consequence of fostering social poverty, thus perpetuating the proverbial law of the jungle that everyone is out only for themselves.

With these assertions, we now turn to two research cases to describe how social capital can or does play a role in the process and system known as microcredit.

**MICROBUSINESS MENTORS**

This MFI began as a university laboratory for service learning in 2003. As a project in my social entrepreneurship course, a team of graduate students worked with others at Brigham Young University to conduct a needs assessment of the growing inner-city Latino community adjacent to campus in Provo, Utah.

In our surveys of inner-city Latino families in Provo, we learned that 48 percent reported having no savings and 71 percent had annual incomes of under US$30,000. When we inquired about their potential interest in becoming self-employed, 81 percent answered in the affirmative. Likewise, 78 percent reported they would be interested in receiving business training. But surprisingly, only 55 percent expressed interest in obtaining a loan.

Thus, we began to feel that the delivery of business skills should be our first priority. Based on these data, MicroBusiness Mentors (MBM) was created to begin marketing our services for empowering the poor near the university campus.

**MBM Programs:** We designed a four-pillar system for operating our program: Spanish language training, group support, mentors, and loans. Briefly put, training seemed to be of interest to 78 percent of Latino adults in our survey. So we designed eight modules, focusing on one each week for eight weeks. During these weeks, the participants learn about each other, work on training cases as a team, and share ideas and experiences, all culminating in the creation of a microenterprise business plan. This system of mutual support builds solidarity and trust, which becomes very important due the following reality.

Our clients emigrate from a large mix of South and Central American nations, each with different Spanish pronunciations, slang, customs, norms and values, and occasional antipathies toward those from other countries. In certain cases, their backgrounds may have included middle-class comforts that they no longer enjoy. In a few instances, their countries may have gone to war.

Graduates, teachers, and student volunteers of the MicroBusiness Mentors Class of 2007
over territory disputes, military conflicts, or most likely, soccer rivalries. Thus, the social capital that grows during their solidarity group experience becomes vital to their microenterprise accomplishments in MBM and, more importantly, to their success in American society. As I have observed, this type of mutual support becomes a critical ingredient.

If group members go on to complete the eight sessions of training and qualify for US$500 loans, they attend a MBM graduation ceremony and receive certificates of completion as well as the loans. Each member of the group signs a commitment to repay each others’ loans in addition to one’s own—the group thereby acting as social collateral. This technique is sometimes referred to as peer lending, village banking, or solidarity group loans. Group commitment and peer pressure serve to minimize borrower default rates.

MBM Results: MBM is yielding quite promising results for facilitating self-employment. I am happy to have played a key role in its founding and to act as board chairman. Hundreds of Utah Latinos have received orientation and/or training. Those who have completed the training have received loans and have started microenterprises, and, so far, 100 percent of them have paid back their microcredit debts. Currently, MBM is partnered with Centro Hispano in Provo, a 501(c) 3 affiliated with the Community Action Agency. Therefore, donors may claim their financial support as a tax deduction. Through this process, MBM will be able to expand its services and loan capital to greater numbers of poor families. The power for creating social capital through MBM’s group process appears to have important consequences among such disparate emigrants from Latin America.

Gradually, indigenous MFIs were formed in the Philippines. The first, in 1990, was the Philippine Enterprise Development Foundation based in Manila. In 1993, a second MFI, Visayas Enterprise Foundation, was established in Cebu, the central region of the Philippines. A third nonprofit organization was established in the southern islands of the Philippines in 1995, the Mindanao Enterprise Development Foundation.

EMI Social Processes: The range of services offered by these MFIs are intended to address microenterprise needs for start-up, growth, productivity, and profitability, with the ultimate objective being individual, family, and community self-reliance. Like MBM, most loans are offered to a group of microentrepreneurs who commit to paying back everyone’s loan, not just one’s own. Again, this process functions as a type of social collateral that, in turn, fosters a sense of mutual support and interconnectedness. Over time, trust expands, one’s legitimacy and dignity grows, and social capital begins to provide community dividends, not just financially but also socially.

The larger picture of EMI as the parent organization is also quite impressive. Altogether it offers more than thirty thousand microloans annually, totaling more than US$5 million and averaging approximately US$150 per loan. Since its organization, EMI has provided microenterprise tools, offered training, and used best practice development services and free consulting. So far, Filipinos have received small loans to start and/or expand microenterprises. Nearly 61 percent of the borrowers are female, and the pay-back rate is 96 percent.

The loans offered through EMI are processed as a type of collaborative credit system formed by the borrowers...
themselves. Members are responsible for one another to pay back the loans. A person will access a loan with his or her peers even though they have no collateral or credit history. The borrower works with people he or she knows or trusts. The group members pay interest and principal daily, but not at exorbitant rates. After the first round of paying back a small loan, the borrower qualifies for a larger loan each successive time.

The self-employed entrepreneurs who participate in the program for more than a year boast more than a 93 percent survival—an outstanding success rate for self-employment. Because of the high repayment rate of loans, EMI’s three Filipino MFIs are nearly 100 percent financially self-sufficient at present.

EMI Ripple Effects: Coupling this loan system with the microenterprise training and hands-on consulting programs makes EMI’s and its MFI partners’ strategy to lift poor Filipinos important because it helps people collectively borrow as a group, thereby leveraging their skills and energy. In recent research my students and I found that through this collaborative model, many social ties and networks were established with potential suppliers and customers from references from the group members.7

In EMI’s Filipino solidarity groups, we witnessed on certain occasions that when a group member experienced problems either related to his or her business or even to his or her personal life, many of the other members would communicate with the individual to find out how they could help and to offer solutions. In other group settings, babysitting and accompanying children to school became a shared responsibility among many of the female entrepreneurs.

SOCIAL CAPITAL DISCUSSION
Drawing from the microcredit cases in the Philippines and Utah, social capital seems to be embedded in the group processes of microentrepreneurs. It is strengthened by training, solidarity group responsibilities, social interactions, mentoring, and sharing best practices. Connections become established, reputations enhanced, influence increased, and friendships deepened. There is an increased access to resources and ideas among participants, and future favors and access to further resources become possible. All of these factors help to establish a reservoir upon which to draw in the future as needed.

In his classic volume on social trust, Francis Fukuyama advocates that social capital is built upon specific informal norms and values, which are shared among a group.8 He suggests that social capital also facilitates the creation of cooperation within a society. It builds a spirit of community. It creates strong social ties to others within a system or collective network. I see a logical extension to microcredit systems of the kind defined at the outset of this paper. This enhances communication and the exchange of information, from which groups of microentrepreneurs greatly benefit. Solidarity groups meet weekly, but not simply to pay back a portion of their loan principle and interest. Together they are able to identify problems, explore root causes, and brainstorm potential solutions. The outcome is increased community well-being.

Similarly, the perspective of Robert Putnam’s work regarding social relations in the United States offers an added twist. His Harvard research bemoans the decline of social capital in the country during past decades, claiming that Americans are more isolated now than at any time in history.9 People do not trust their governments, their communities, or each other, leading to increasingly lower levels of civic participation. The primary importance of social capital for his Harvard project is using it as a resource for public good, for societal involvement—in other words, civic engagement. Putnam writes that social capital has to do with “the collective value of all ‘social networks’ and the inclinations that arise from these networks to do things for each other.”10

Perhaps social capital becomes an asset embedded in relationships that facilitate instrumental action among people and the sharing of knowledge and resources from one person to another, as occurs in effective microcredit solidarity groups. In essence, social capital may

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AMERICANS ARE MORE isolated NOW THAN AT ANY TIME IN HISTORY. PEOPLE DO NOT TRUST THEIR GOVERNMENTS, THEIR COMMUNITIES, OR EACH OTHER.
establish connections that allow microcredit clients to exchange resources and manage knowledge effectively. Organizational theorists might suggest that social capital also reduces organizational costs by increasing an organization’s ability to acquire new knowledge.

Thus, the benefits of social capital are huge, and one might argue that social capital is, at least initially, more important than the amount of financial capital a microcredit client starts with in his or her first loan. There is much potential for give-and-take as the relationship between the solidarity group members becomes symbiotic. Members benefit greatly as their businesses grow and new tools are developed. All this is much greater than the act of a single individual or even a group that lacks social capital. Microentrepreneurs are able to leverage their relationships, and for the MFI, such dynamics also attract new clients and borrowers who want to achieve the same.

Thus, solidarity groups germinate more groups, and as time passes, social networks expand exponentially. In this sense, social capital becomes interpersonal bonding capital. Accomplishments are rewarded. MFI members recognize each other’s successes and build up future favors by doing so, thus expanding social capital of their own.

Microentrepreneurs gain power from the support of others. They feel they can overcome any difficult situation and move toward greater self-actualization—for the group, not just one individual.

CONCLUSIONS

In applying the concept of social capital to these microcredit cases, it becomes clear that the work of MFI managers is not simply a matter of accounting or repayment of loans. Instead, a significant amount of their time and energy needs to go into facilitating the processes of social capital among their bank members. In essence, it becomes an intangible but important asset for the MFI. With a growing stock of social capital, I would predict that not only will microentrepreneurs expand their tiny enterprises faster, larger, and be able to achieve greater economic success on the business side, but they will become increasingly committed to the MFI’s mission and the attainment of long-term impacts. Such experience will
give them a deeper sense of purpose and meaning and a greater amount of confidence that they can eventually climb out of poverty by collaborating with others. Furthermore, I would suggest that the power of social capital reduces group members’ stress that stems from economic adversity, death of a loved one, the devastation of natural disasters and wars, etc.—all of which are so common among the poorest of the poor, those who are socially disadvantaged.

As described in Yunus’ criteria for microcredit, an emphasis on group interactive processes is critical. Financing the poor and using social capital in doing so serves to foster resiliency among such individuals and may build economic self-reliance. It will also generate greater socioeconomic justice in a world where millions of families now suffer.

Endnotes
3 Herbert Spencer, Social Statics (New York: D. Appleton, 1866); Richard Hofstadter, Social Darwinism in American Thought (New York: George Braziller, 1959).
6 Christopher Thompson, Microcredit Results in the Philippines (unpublished report, 2005).

ABOUT THE AUTHOR

Warner P. Woodworth is a social entrepreneur and professor at Brigham Young University’s Marriott School of Management. He is also a consultant to major corporations, governments, NGOs, and trade unions. Woodworth has produced ten books and more than two hundred articles, book chapters, and conference papers. He has been a founder and/or director of sixteen NGOs that in 2007 alone raised more than US$28 million and grew to more than 3 million poor clients.

The author thanks his former students Chris Thompson, Shon Hiatt, and Shad Morris for field research and assistance in drafting brief reports on several MFI cases.
The traditional view of global poverty assumes that there are one billion people living in rich countries with the remaining five billion residing in the developing world. And yet as the world becomes more globalized, many of the bottom five billion are beginning to climb the economic ladder and are escaping the generational cycle of poverty. Various countries, such as China and India, have seen unprecedented levels of economic growth coupled with rapidly declining poverty rates. But as these countries continue to grow, it becomes increasingly apparent that others are falling behind.

Paul Collier, former research director for the World Bank and current director of the Center for the Study of African Economies at Oxford University, has spent his life working to alleviate global poverty. With more than thirty years of development experience, Collier is indeed in tune with the needs of the poor. More importantly, the arguments in his book, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It*, are not mere opinions but rather empirically based conclusions that stem from his exhaustive list of peer-reviewed research.

In the first section, Collier declares that the real challenge of poverty elimination is that a group of countries are caught in a development trap and are consequently falling behind and falling apart. According to his definition, approximately one billion people—the bottom billion—are living in these countries. A closer analysis reveals that the economic growth of the bottom billion has actually declined since the 1970s. He believes that the reason they have not grown is because they have fallen into one or more of the following four traps: (1) conflict, (2) natural resources, (3) geography, and (4) poor governance.

Although all societies have conflict, Collier’s first identified development trap is internal violence. Collier and his colleagues have identified three causes that lead to civil war: low initial levels of income, slow growth or stagnation, and dependence on natural resource commodities. The first two causes, low income and slow growth, lead to poverty and hopelessness. Consequently, many young men may join a rebel movement, preferring life as a soldier with a small chance of riches to a life of despair with little or no opportunities to succeed. On average, a typical civil war in a developing country will last seven years. With the cost of war averaging US$64 billion annually, it becomes clear why patterns of war and violence can impede the economic growth of a country.

Empirical research also shows that countries with high proportions of natural resource revenues tend to grow slower than other countries that have diversified exports. This “resource curse,” also known as Dutch disease, occurs when resource exports cause a country’s currency to rise in value against other currencies, thus making the country’s other export activities uncompetitive. Collier also proposes that resource revenues distort...
The real challenge of poverty elimination is that a group of countries are caught in a development trap and are consequently falling behind and falling apart.

democracy by altering elections through patronage politics, reducing the need to tax, and eroding the system of checks and balances. The most drastic consequence of the natural resource trap is that resource-rich nations tend to either under-invest or invest poorly, choosing to expand production of the resource at the expense of other national needs.

Perhaps the most unfortunate of the four traps, the geography of a nation has a significant impact on that nation’s overall capacity to grow and expand. Many empirical studies show that countries that are landlocked and/or are surrounded by other poor countries tend to grow slower because the economic success of a country depends on the infrastructure and economic performance of its neighbors. Not only do these neighboring countries act as transport corridors for exports, but they also serve as markets for a poor country’s goods and services. Collier notes that this is why Switzerland and Botswana, two landlocked countries, have had relative economic success. Switzerland can sell its products to Germany and use its ports for exports. The same holds true for Botswana and South Africa.

Collier’s last identified development trap is poor governance. Excellent governance can lead to economic growth when opportunities for growth exist. Poor governance, however, can quickly lead to economic destruction that can take years to rebuild. Collier believes that poor governance and corruption persist because there is no incentive to change—the corrupt politicians and bureaucrats are the ones who benefit from poor economic policy. The lack of education also makes replacing corrupt leaders an extremely arduous task. Consequently, many of these poor countries will continue to struggle economically unless this cycle can be broken.

All people living in the bottom billion have been caught in one or more of these traps: 73 percent have been through civil war, 29 percent live in countries where politics are dominated by natural resource revenues, 30 percent are landlocked and/or are surrounded by poor countries, and 76 percent have suffered from the consequences of poor governance. These traps, fortunately, are not permanent. By leveraging their strong points, such as low wages and high labor supply, many developing countries have been able to actively participate and benefit from globalization to escape these poverty traps.

However, Collier believes that the world’s poorest countries may have missed the boat. In line with
his empirical research, he theorizes that despite having low wages, the bottom billion cannot at this time compete with China and other Asian manufacturing centers due to the economies of scale associated with industry agglomeration. Of course, in time the chance will return—the bottom billion will have an opportunity to actively compete in these markets. But according to Collier, this event will not occur until the wage gap between Asia and the bottom billion is sufficiently high to overcome the economies of scale enjoyed by high- and middle-income countries. Although it may be years before that wage gap is large enough, it is clear that once a country can overcome this threshold, the benefits will include profits for firms, job creation for the unemployed, and higher wages for the poor, ultimately leading to economic growth and security for those who have never had an opportunity to succeed.

In the fourth section, Collier introduces several policy instruments that can be used to address the problems of the bottom billion. Although he is somewhat skeptical of its current politicized image, Collier first proposes that foreign aid be directed toward coastal countries in order to finance a big push for industrialization and infrastructure development, remembering that such actions benefit not only the recipients of aid but also the landlocked countries that rely on their neighbors for marketing and exporting. Second, Collier cautiously supports the notion of military intervention as a necessary step to break the cycles of civil war and violence that are so often present in poor countries. Third, he suggests that international laws and norms be established that benefit the bottom billion and align the incentives of all nations with the goals of global poverty eradication. Finally, he proposes that trade reforms be made in favor of the bottom billion so that they might be able to compete in the global marketplace.

Collier concludes with an agenda of action specifically directed toward the G8, an international forum for the world’s largest industrialized democracies, and with three propositions that ordinary citizens might undertake to reverse the diverging trend of the bottom billion: (1) focus our efforts on the bottom billion, those who are trapped and are diverging from the rest of the globalized world; (2) understand that despite our best efforts, true change must come from within; and (3) commit ourselves to actively and intelligently participate in our quest to eliminate global poverty.

Whether or not you agree with Collier’s arguments, there is no doubt that his ideas and theories are supported by comprehensive research. Unfortunately, without a basic understanding of economics, readers may have some trouble understanding the technical jargon. Others may find it somewhat presumptuous that the arguments and ideas are largely based on his own research, and some may find it too academic.

I found Collier’s ideas and theories to be insightful and refreshing. As an intern in Kenya and Mozambique, I have seen firsthand the problems and struggles of the bottom billion. The plight of the poor is real, and the road to economic freedom is long and ridden with obstacles. Although he may not have all the answers, Collier’s solutions provide a systematic approach to global poverty eradication that can equalize the global standard of living and free the bottom billion from development traps—a truly desirable aim.

ABOUT THE REVIEWER

Ben Lewis became interested in development work while serving a mission for The Church of Jesus Christ of Latter-day Saints in Brazil. After that time, he spent two summers in Mozambique and Kenya as an intern for Care for Life and Coast Coconut Farms. Lewis completed his undergraduate work in accounting and economics and his graduate work in accounting in August 2008 at Brigham Young University. Lewis is a doctorate student at Cornell University in business management.
The MicroFranchise Development Initiative (MFDI) at the ESR Center continues to research the implementing of microfranchises in developing countries. The ESR Center believes microfranchising can ultimately help more individuals and families alleviate poverty, enhance economic self-reliance, and stimulate individual, community, and country economic development.

The ESR Center continues to pursue its international research efforts. Its focus is currently a longitudinal study of the effectiveness of microfranchising. During the past two years, the ESR Center has sent students to Bangladesh, Guatemala, and Ghana to collect data on the differences between stand-alone businesses, microcredit businesses, and microfranchises.

This last summer, the ESR Center sent two students to Ghana for two months to collect data from various regions of the country. They interviewed approximately 160 small-business owners. The franchisees worked mostly with Fanmilk, a leading manufacturer of ice cream and yogurt in Ghana. Fanmilk is an ideal microfranchise because it does not require much skill or start-up cost. To begin, the franchisee has to pay a deposit and is given a bike, uniform, and basic training. The organization covers the advertising, supply chain, and storage of the product. The franchisees typically make between US$2 and US$12 per day, depending on the hours they work, their route, and the weather. The microfranchise gives experience in creating and running a business. A large majority of the franchisees work for a couple of years and then move on to their own business.

Other initial research found that, overall, the business owners in all three business models have a large range of effectiveness. Most have no education and typically go into the business to which they are first introduced. Many are not entrepreneurs but have been forced to start their own business out of necessity. Most sell nothing that would distinguish themselves from the person next to them. Bookkeeping or record keeping are minimal, and it is very much a day-to-day business. The overall sentiment of these business owners was: “If I have extra money, I buy stuff. If I don’t, I don’t.” However, there are some business owners who are more strategic and successful. These individuals have more education and understand how to run a business, to plan ahead, to be efficient, and to make goals.

Within the next few months, MFDI will compile the data from Ghana and the other countries and hopes that it will show a linear progression—that people are more successful in a microfranchise as opposed to other business models and that the businesses grow over time. The goal is to prove that franchisees will be able to gain experience and save money and capital to move forward. The ESR Center will maintain its international research efforts to help many around the world understand the effectiveness of microfranchising.
Single Mom Initiative Enters the Next Phase

This year has been an important year for the ESR Center’s Single Mom Initiative (SMI). During the year, the SMI began sharing results from the statewide survey of Utah single mothers that it conducted during 2007. The SMI also began the next phase of single mother research—in-depth interviews with approximately thirty of the survey respondents.

A preview of the findings from the statewide survey was shared with participants in the November 2007 ESR Conference. Afterward, the findings were published in the Spring 2008 issue of ESR Review. The survey findings highlight the importance of education to the economic self-reliance of Utah’s single mothers. The data analysis demonstrated that education is a key predictor of a single mother’s economic self-reliance. Average income for Utah single mothers increases with each increase in educational level. However, it is not until a single mother earns a bachelor’s degree that she is likely to earn enough to live out of poverty and achieve a degree of self-sufficiency.

The SMI also began the next phase of its research effort during 2008. Five student research assistants began conducting face-to-face interviews with approximately thirty of the single mother survey participants. The interview participants live throughout Utah and include both English- and Spanish-speaking single mothers. The information gathered in the interviews will allow the SMI to gain a more in-depth understanding of some of the most interesting findings from the survey surrounding issues of education, finances, support systems, and child care.

The SMI plans to continue sharing research findings with practitioners and researchers as they become available. Analysis of the survey data will be ongoing, and an additional report based on survey findings will be available on the ESR Center’s web site shortly. The SMI expects the additional results from the survey and follow-up interviews will continue to contribute to a more complete understanding of the lives of single mothers and the best strategies for helping them build their economic self-reliance.

Utah Single Mom

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For the fifth consecutive year, the ESR Center has hosted the Social Venture Competition (SVC). This competition allows students to share their interest in local, national, and global social issues by creating business plans with a social mission. Aaron Miller, faculty member and director of the competition, stated, “BYU is recognized as one of the more entrepreneurial campuses in the country, and this, coupled with the student body’s strong commitment to give aid around the world, results in the students’ proactive and innovative approaches to addressing social problems right away.”

Last year’s winner was S4: Students for Self-Sustainable Schools. Their plan consisted of building a hotel in the Kancheepuram district of India in order to raise and maintain funds to support a charitable school associated with a leprosy colony. The hotel would also provide an opportunity for older students to work and develop various skills in order to break the cycle of poverty. S4 won a total of US$25,000 in cash to help fund its project. Second place was awarded to School Tipline, an online tool that allows students to anonymously report bullying and threats. The third place award went to Next Deseret, an organization that helps finance nonprofit surgical centers in developing countries. This year, in addition to the funds that were awarded, each finalist team has the opportunity to earn additional support funds from the ESR Center by meeting outlined objectives by March 2009.

During this past summer, each team has worked diligently to receive the additional funding. Two of the teams have had the opportunity to go their respective developing countries to start their business ventures. S4 partnered with Rising Star Outreach of India and was able to research the development of their initial phases of the project and gain hands-on experience in understanding how to implement their social business plan. Next Deseret was able to partner with Deseret International and travel to Peru to begin the initial phases of their plan.

Although the excitement of starting new ventures and monetary awards are used as incentives to encourage students to plan and carry out their innovative ideas, those who participate in the competition learn lifelong lessons and gain invaluable experience. Brian Hill, an S4 team member, commented how his experience “provided global perspective and understanding in how not only to enable the people in developing countries but also to impact the entire economic system.”

As the competition has evolved, the number of submissions has increased, but most importantly, the quality of the proposals has been exceptional. “Our goal this coming year is to penetrate as many disciplines as we can and have more involvement from faculty members,” adds Miller. “This is an opportunity for students and faculty to have a mentorship experience and for everyone to learn what social entrepreneurship is.”
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